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#### COMMONWEALTH OF VIRGINIA

### STATE CORPORATION COMMISSION

AT RICHMOND, JUNE 22, 2001

APPLICATION OF

THE POTOMAC EDISON COMPANY d/b/a ALLEGHENY POWER

CASE NO. PUE000280

For approval of functional separation plan

# ORDER PRESCRIBING NOTICE AND INVITING COMMENTS AND/OR REQUEST FOR HEARING

On December 19, 2000, the Potomac Edison Company d/b/a Allegheny Power Company ("AP" or "Company") filed an application in Case No. PUE000280 pursuant to § 56-590 of the Code of Virginia, for approval of the second phase ("Phase II") of its plan for functional separation of its generating assets from its transmission assets, as required by the Virginia Electric Utility Restructuring Act, Chapter 23 (§ 56-576 et seq.) of Title 56 of the Code of Virginia (the "Act").

<sup>&</sup>lt;sup>1</sup> On October 16, 2000, The Company filed an application in this docket, Case No. PUE000280, requesting the Commission to accept its Memorandum of Agreement with the PJM Interconnection, L.L.C, an independent system operator as satisfying the Company's obligation under the Act to join or establish a regional transmission entity ("RTE") no later than January 1, 2001. By Order dated December 20, 2000, the Commission established a separate case, Case No. PUE000736, Commonwealth of Virginia, ex rel. State Corporation Commission, Ex Parte: The Potomac Edison Company d/b/a Allegheny Power, Regional Transmission Entities, for the purpose of considering the RTE Matters separate and apart from the issues in this proceeding.

AP filed its application for approval of the first phase, of its functional separation plan ("Phase I") on May 25, 2000. Phase I of AP's functional separation plan involved the Company's proposal to separate its generation facilities from its transmission and distribution facilities by transferring its generating assets, certain utility securities, and certain contractual entitlements to generation to an affiliate, Allegheny Energy, LLC.<sup>2</sup>

On July 11, 2000, the Commission issued an order in this docket approving the Phase I transfers subject to the terms of the Memorandum of Understanding ("MOU"), as supplemented, negotiated between AP and the Commission Staff ("Staff"). On

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<sup>&</sup>lt;sup>2</sup> At the time of its original Phase I filing, the Company referred to the generation affiliate as "GENCO." The Company's Phase II application identifies the affiliate as Allegheny Energy Supply, LLC ("Allegheny Energy").

 $<sup>^3</sup>$  Application of the Potomac Edison Company  $extstyle{d/b/a}$  Allegheny Power, For approval of a functional separation plan, Case No. PUE000280, Order Approving Phase I Transfers (July 11, 2000). The Company filed in its Phase I application a Memorandum of Understanding ("MOU") it reached with the Staff. In the MOU, the Company agreed to certain representations and undertakings in order to comply with requirements in the Act. In the MOU, the Company agreed to: (i) reduce base rates of its Virginia customers of \$1 million annually, effective July 1, 2000; (ii) not file an application for a base rate increase prior to January 1, 2001; (iii) operate and maintain its distribution system in Virginia at or above historic levels of service quality and reliability, and to maintain that quality of service through timely improvements needed; (iv) provide default service under the Act by contracting for generation services for default service customers at the same cost that it would incur to serve customers from the units it owned at the time of the filing of its application, before divestiture to Allegheny Energy; and (v) terminate its fuel factor cost recovery mechanism and recover fuel costs in base rates. In the July 11, 2000 Order, the Commission approved several of the provisions of the MOU but reserved consideration on the MOU provisions that related to the elimination of the fuel factor; reserving those issues to the hearing scheduled on July 20, 2000.

July 26, 2000, the Commission approved an expanded settlement between Staff and AP in its Order Approving Elimination of Fuel Factor and Establishing Capped Rates.<sup>4</sup>

In its current application for Phase II for its plan for functional separation, AP indicates that the Phase I transfers previously approved by the Commission were effective August 1, 2000. The Company's application states that AP transferred all of its generating assets to Allegheny Energy, except for four hydroelectric generating facilities located in Virginia. We note that the Commission approved the transfer of the hydroelectric facilities on December 14, 2000 in its final order in Case No. PUA000064, to a subsidiary of AP, Green Valley Hydro, L.L.C., which, according to AP, was to become a subsidiary of Allegheny Energy.<sup>5</sup>

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<sup>&</sup>lt;sup>4</sup> Application of the Potomac Edison Company d/b/a Allegheny Power, For approval of a functional separation plan, Case No. PUE000280, Order Approving Elimination of Fuel Factor and Establishing Capped Rates (July 26, 2000). In the July 26, 2000 Order, the Commission approved the elimination of the fuel factor recovery mechanism in AP's rates, ordered the Company's fuel expenses, estimated in the MOU at 1.181 cents/kWh to be rolled into its base rates, approved the proposed \$1 million rate reduction, and established capped rates. The Commission also approved the Company's agreement not to impose any wires charges during the capped rate period.

See Application of the Potomac Edison Company d/b/a Allegheny Power, For approval of transactions under Chapters 4 and 5 of Title 56 of the Code of Virginia, related to the transfer of utility assets and utility securities to an affiliate, Case No. PUA000064, Order Granting Approval (December 14, 2000). Ordering Paragraph (5) required AP to submit a report of action including the date of transfer, description of assets, and the accounting entries reflecting the transactions to the Commission's Director of Public Utility Accounting within sixty (60) days of the authorized transfer. To date, the Company has not filed a report notifying the Commission of the completion of any of the approved transfers.

Pursuant to the Commission's Regulations Governing The Functional Separation Of Incumbent Electric Utilities Under The Virginia Electric Utility Restructuring Act, 20 VAC 5-202-10 et seq. (the "Rules"), in Phase II of its application, AP has filed cost of service studies, as required in the Rules. The Company filed studies reflecting total company and total Virginia operations, and reflecting Virginia jurisdictional and Virginia non-jurisdictional operations, for the 12 months ended December 31, 1999. As required by the rules, the Company also filed a cost of service study that separates Virginia jurisdictional operations by class and function for the twelve months ended December 31, 1999. According to the Company, the study was based on the cost of service study in the Company's most recent AIF, but includes adjustments to revenue to annualize rates effective August 7, 2000, as approved by the Commission in this proceeding.

The Company has also filed proposed retail access tariffs, which, according to the Company, contain certain revisions and additions to its current retail electric service tariffs. AP's proposed retail access tariffs separate bundled monthly rates for service into unbundled components to reflect distribution, transmission and generation charges. Transmission charges are

<sup>&</sup>lt;sup>6</sup> <u>See Application of the Potomac Edison Company d/b/a Allegheny Power, For approval of a functional separation plan, Case No. PUE000280, Order Approving Elimination of Fuel Factor and Establishing Capped Rates (July 26, 2000).</u>

also unbundled into base and ancillary services. The Company describes in its application how the unbundled rates were calculated. According to the Company, to calculate the rates, AP first established jurisdictional annualized revenues using rates and billing determinants based on those previously established in this proceeding. Annualized revenues were calculated from base rates effective August 2000, and billing determinants from a test period for the 12 months ended December 31, 1999.

Significantly, the Company's retail access tariffs also include a "minimum stay provision" for non-residential customers who voluntarily choose to return to default service. The tariff requires a minimum contract term of one year for non-residential customers who voluntarily return to AP's default service.

However, if a non-residential customer is returned to default service because its competitive service provider defaults, the customer may return to default service until it chooses a new authorized competitive service provider, as long as the customer begins to take supply from a new competitive service provider within 90 days from the effective date of the customer's initial return to default service.

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 $<sup>^{7}</sup>$  <u>See</u> note 6, at p. 4, supra.

In addition, the Company states in its application that while no changes are proposed at this time to its line extension plan, the Company may propose modifications at a later date to reflect retail access. Further, AP is not proposing any changes to its co-generation schedule which is part of the Company's MOU agreement with Staff, but the Company indicates it will file to modify this schedule after December 31, 2001.

AP also filed in its tariffs a "Competitive Service Provider Coordination Tariff," which AP states is to define the operational relationship between the Company and competitive service providers for their provision of competitive generation service in the Company's territory. The Company's competitive service provider coordination tariff addresses, for example, such issues as creditworthiness requirements, noncompliance and default, load forecasting and scheduling procedures, and competitive service provider customer billing.

The Company represents that it expects to comply fully with the Commission's rules governing relations between affiliated functionally separated entities as set forth in 20 VAC 5-202-30. Furthermore, it indicates that as a subsidiary of a public utility holding company, AP is required to account for intra holding company system transactions at fully distributed cost as opposed to the asymmetric pricing requirement set forth in the Commission's rules. The Company states that because of the

limited number of transactions between AP and Allegheny Energy,
AP does not believe that this requirement will present
significant problems at this time. If problems should arise,
the Company represents that, it may request a waiver or
exemption from this requirement.

NOW THE COMMISSION, upon consideration of this matter, is of the opinion that notice should be given of the Company's filing in this matter, and that interested parties should have the opportunity to comment and request a hearing on the application.

Section 56-590 B 2 of the Code of Virginia requires the Commission to "direct the functional separation of generation, retail transmission and distribution of all incumbent electric utilities." As noted above, the Commission approved the transfer of all of AP's generating assets to affiliates in previous orders it issued last year. Additionally, the Commission has also previously approved the elimination of the fuel factor recovery mechanism in AP's rates and established capped rates.

Under the Act, AP must obtain approval from the Commission of the unbundled rates, the retail access tariffs and the competitive service provider tariffs included in Phase II of the Company's application for its plan for functional separation.

The Company has not requested any waivers or exemptions from the filing requirements in the Rules.

Accordingly, IT IS ORDERED THAT:

- (1) AP shall promptly make a copy of its application and supporting materials available to the public who may obtain a copy of the application, at no charge, by requesting it in writing from AP's counsel at the address detailed below.
- (2) Any interested person may submit comments or requests for hearing on or before July 27, 2001, by filing such written comments and/or requests with Joel H. Peck, Clerk, State Corporation Commission, c/o Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Said comments or request for hearing shall refer to Case No. PUE000280. Any request for hearing shall detail reasons that such issues cannot be adequately addressed in written comments.
- (3) Any person filing comments or filing a request for hearing shall also file, on or before July 27, 2001, a notice of participation in accordance with Rule 5 VAC 5-20-80 B of the Commission's Rules of Practice and Procedure, 5 VAC 5-20-10 et seq.
- (4) A copy of such comments, requests for hearing, and notice of participation shall simultaneously be sent to counsel for the Company as follows: Philip J. Bray, Esquire, Allegheny

Power Company, 10435 Downsville Pike, Hagerstown, Maryland 21740-1766.

- (5) The Commission Staff shall review the application and shall, on or before September 4, 2001, file a report detailing the results of its investigation.
- (6) AP shall respond to written interrogatories within seven (7) calendar days after receipt of same. Except as modified above, discovery shall be in accordance with Part IV of the Commission's Rules of Practice and Procedure, 5 VAC 5-20-10 et seq.
- (7) On or before July 11, 2001, the Company shall publish the following notice to be published as display advertising (not classified) on one occasion in newspapers of general circulation throughout its service territory:

NOTICE TO THE PUBLIC OF AN APPLICATION BY THE POTOMAC EDISON COMPANY D/B/A ALLEGHENY POWER, FOR APPROVAL OF A PLAN FOR FUNCTIONAL SEPARATION OF ITS GENERATION ASSETS FROM ITS TRANSMISSION AND DISTRIBUTION ASSETS UNDER THE VIRGINIA ELECTRIC UTILITY RESTRUCTURING ACT, CASE NO. PUE000280

On December 19, 2000, Potomac Edison Company d/b/a Allegheny Power ("AP" or the "Company") filed an application with the Virginia State Corporation Commission ("the Commission"), pursuant to Virginia Code § 56-590 B of the Virginia Electric Utility Restructuring Act ("Restructuring Act" or "the Act"), for approval of the second phase ("Phase II") of its plan for the functional separation of its generation, transmission

and distribution assets, and activities (the "Application").

In its current application for Phase II, the Company states that, effective August 1, 2000, it transferred all of its generating assets except its four Virginia hydroelectric facilities ("hydro") to Allegheny Energy, LLC ("Allegheny Energy"). On December 14, 2000, the Commission approved the transfer of AP's four hydroelectric facilities. AP was to provide the Commission sixty days notice of the transfer of the hydro facilities. As of yet, no notice of the approved transfers has been filed with the Commission.

In its Phase II application, the Company filed proposed retail access tariffs that separate bundled monthly rates for service into unbundled components to reflect distribution, transmission and generation charges. Transmission charges in the Company's tariff are also unbundled into base and ancillary services. The Company describes in its application how it calculated the proposed unbundled rates. represents that in calculating its unbundled rates, the Company first established jurisdictional annualized revenues using rates and billing determinants based on those previously determined in this case. The annualized revenues were calculated from base rates effective August 2000, and billing determinants from a test period for the 12 months ended December 31, 1999.

Significantly, AP's retail access tariffs also include a "minimum stay provision" for non-residential customers. The tariff requires that non-residential customers who voluntarily return to AP's default service must sign a one year minimum contract to receive electricity generation from AP. However, if a non-residential customer is returned to default service because its competitive service provider

defaults, the customer may return to default service until it chooses a new authorized competitive service provider, as long as the customer begins to take supply from a new competitive service provider within 90 days from the effective date of the customer's initial return to default service.

The Company also states in its application that while no changes are proposed at this time to its current tariff provisions relating to the Company's line extension plan, the Company may propose modifications at a later date to reflect retail access. The application also states that the Company is not proposing any changes to its co-generation schedule, but will file to modify Schedule CO-G after December 31, 2001. AP also filed a "Competitive Service Provider Coordination Tariff," which the Company states is to define the operational relationship between the Company and competitive service providers for their provisions of electric generation service in the Company's service territory.

The Company further states that it expects to fully comply with the Commission's rules governing relations between affiliated functionally separated entities as set for in Commission rule 20 VAC 5-202-30. It represents that as a subsidiary of a public holding company, it is required to account for intra holding company system transactions at fully distributed cost as opposed to the asymmetric pricing requirement set forth in the Commission's rules. The Company represents though that because of the limited number of transactions between AP and Allegheny Energy, AP does not believe that this requirement will present significant problems at this time; if problems should arise, the Company represents that it may request a waiver or exemption from this requirement.

A copy of the captioned application is available for inspection between the hours of 8:15 a.m. and 5:00 p.m. in the Commission's Document Control Center located on the first floor of the Tyler Building, 1300 East Main Street, Richmond, Virginia. The application may also be requested in writing from AP's counsel at the address noted below.

Comments on the application or requests for hearing must be submitted in writing to Joel H. Peck, Clerk, State Corporation Commission, P.O. Box 2118, Richmond, Virginia 23218, on or before July 27, 2001, referring to Case No. PUE000280, and shall also be served on AP's counsel at the address noted below. Requests for the hearing shall state why a hearing is necessary and why such issues cannot be adequately addressed in written comments. Any person filing comments or filing a request for hearing shall also file a notice of participation as required by Rule 5 VAC 5-20-80 B of the Commission's Rules of Practice and Procedure on or before July 27, 2001.

All correspondence should refer to Case No. PUE000280. A copy of any comments or request for hearing, and notice of participation must also be sent to counsel for AP as follows: Philip J. Bray, Esquire, Allegheny Power Company, 10435 Downsville Pike, Hagerstown, Maryland 21470-1766.

If no sufficient request for hearing is received, a formal hearing might not be held.

Interested persons may obtain a copy of the Commission's Order Prescribing Notice and Inviting Comments and/or Request for Hearing establishing the proceeding in this matter and setting forth the complete procedural schedule applicable thereto, from the Commission's Web site,

http://www.state.va.us/scc/caseinfo/orders.htm, or by directing a written request for a copy of the same to Joel H. Peck, Clerk of the Commission, at P.O. Box 2118, Richmond, Virginia 23218, and referring to Case No. PUE000280.

## THE POTOMAC EDISON COMPANY D/B/A ALLEGHENY POWER

- (8) On or before July 18, 2001, the Company shall serve a copy of this Order upon governmental entities within its service territories as follows: (i) upon the Chairman of the Board of Supervisors of any county, (ii) upon the mayor or manager of any county or city, or (iii) upon officials comparable to the foregoing within counties, cities, or towns having alternate forms of governments. Service shall be made by first-class mail, or by delivery to the customary place of business or the residence of the person served.
- (9) On or before September 20, 2001, the Company and any interested person may file with the Clerk of the Commission any response to Staff's Report.
- (10) On or before July 18, 2001, the Company shall file with the Clerk of the Commission proof of the notice and service required by ordering paragraphs (7) and (8).
- (11) This matter is continued for further orders of the Commission.